FOR ADVISER USE ONLY

Irish Life

INVESTMENT OUTLOOK

2019

Irish Life Investment Managers are part of the Great West Lifeco group of companies, global leaders in financial services. We have €69.6 billion* in assets under management on behalf of our domestic and international clients who trust, believe and invest in our award-winning investment capabilities. In return, we aim to deliver class-leading service and products to our customers, both domestically and internationally.

*Source: ILIM, correct as at 30/11/2018

As a proud ambassador for the UN Principles for Responsible Investment, ILIM are leaders in driving ESG investing in Ireland – influencing positive change in environmental, social and governance issues to create more socially conscious, sustainable and long-term investor returns.

Irish Pensions AWARDS 2017
WINNER
Investment Manager of the Year

Irish Pensions AWARDS 2017
WINNER
Equities Manager of the Year

Irish Pensions AWARDS 2018
WINNER
Property Manager of the Year

Irish Pensions AWARDS 2018
WINNER
Passive Manager of the Year

European Pensions AWARDS 2018
WINNER
Passive Manager of the Year

2018 was the fifth most volatile year for global equity markets since 2009, with periods of strength followed by numerous drawdowns driven by many and varying events throughout the year. Despite reaching new all-time highs in late September, in performance terms, global equities experienced their worst year since the financial crisis. Equities fell sharply in the fourth quarter, negatively impacted by growing fears over a possible recession in 2019, which were exacerbated by concerns around the US Federal Reserve's (Fed) interest-rate policy. The central bank indicated two further interest-rate hikes in 2019 following the four increases in 2018. Political tensions across the globe and continued uncertainty in relation to the ultimate outcome of the trade war between the US and its major trading partners, especially China, also acted as significant headwinds for equity markets throughout the year.

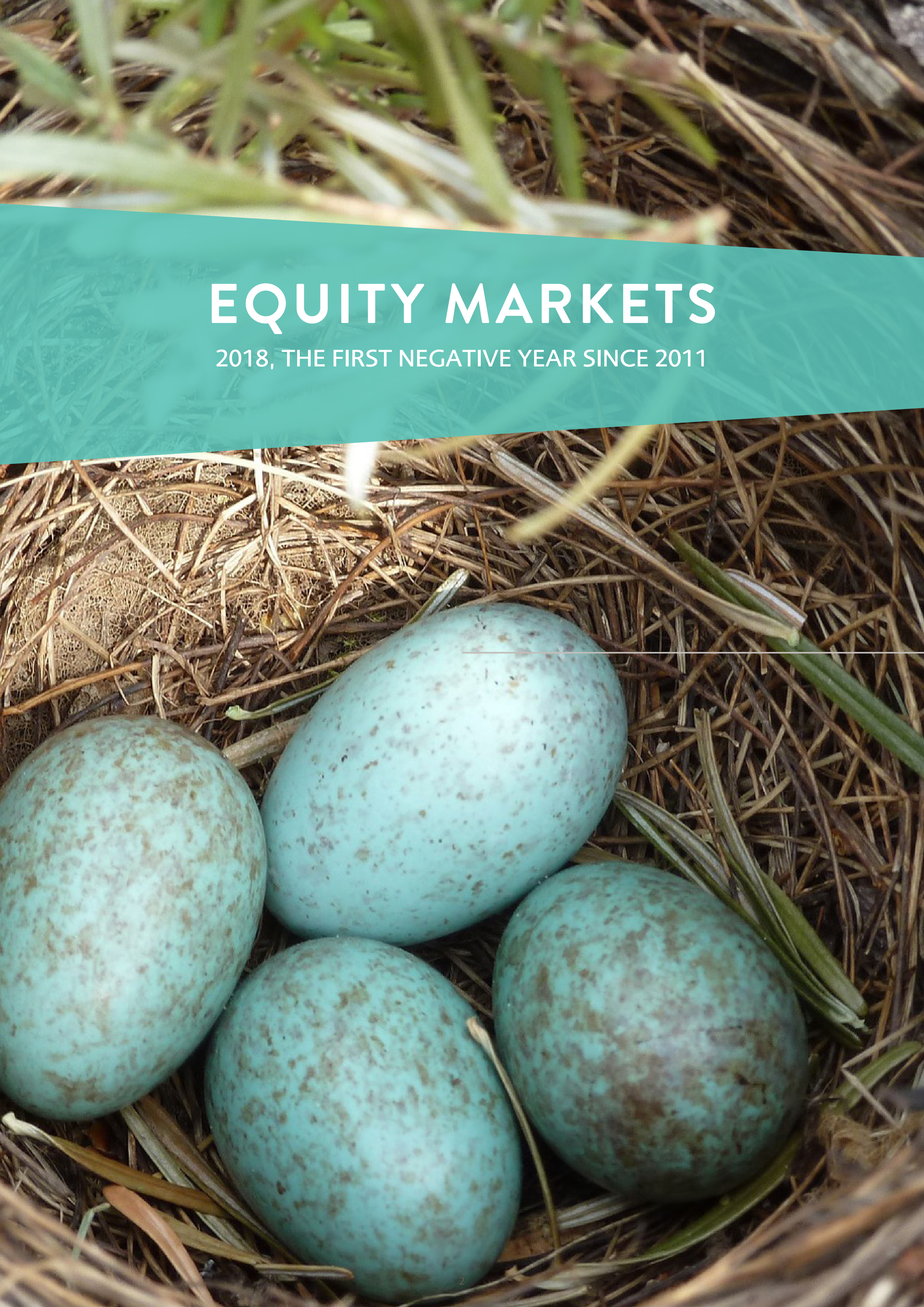
While early 2019 has started on a positive note for equity markets, investors are sure to face some challenges along the way – some known, some unknown as yet. Our job as investment managers is not only to be aware of developments in stock markets in real time, but to be prepared in advance to manage their impact. We work closely with financial advisers to manage the investment journey for their customers and help keep them appropriately invested.

This Investment Outlook reviews the major themes of 2018 that have impacted global equities, bonds, alternative assets and Irish property. With contributions from our in-house fund managers and chief economist, we also examine the likely drivers of markets in 2019. We thank you once again for your support in 2018, and wish you the best for the year ahead.

CONTENTS

EQUITY MARKETS

2018, THE FIRST NEGATIVE YEAR SINCE 2011

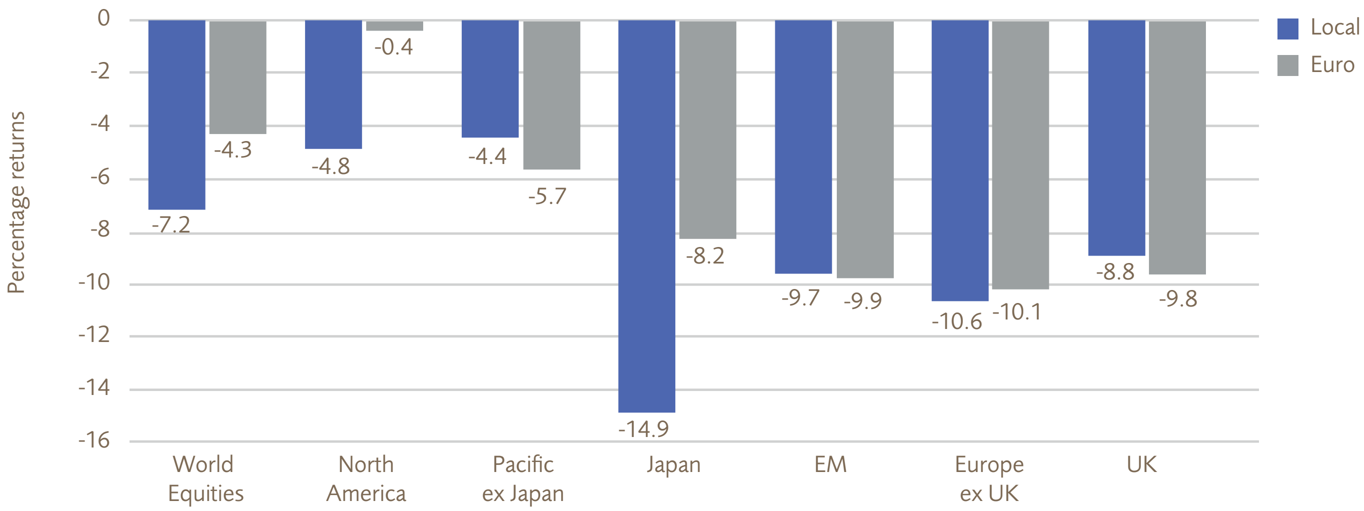


SECTION 1

EQUITY MARKETS – 2018, THE FIRST NEGATIVE YEAR SINCE 2011

- 2018 review
- 2019 outlook
- Economic backdrop
- Summary

EQUITY MARKET PERFORMANCE 2018



Source: Bloomberg

2018 REVIEW

Global equities experienced their worst year since the financial crisis in 2018, falling -7.2% in local currency terms. However, losses were slightly less in euro terms, at -4.3%, given the weakness in the currency, particularly from April onwards.

The year began with optimism about the prospects for both the global economy and equity markets, underpinned by the fiscal stimulus packages announced in the US in late 2017 and early 2018, which were expected to boost both growth and corporate earnings both domestically and globally. However, equities experienced a temporary sell-off in late January and early February when a surprise rise in US wage inflation gave rise to fears of possibly higher US rates and bond yields.

As US and global growth remained solid, and the rise in yields was kept in check, this setback was overcome, leading equities to trend higher through the summer months until late September. At this point, global equities had risen over 6% to date.

However, the synchronised global growth which drove equity markets in 2017 was replaced by an environment which has become significantly more reliant on the US economy. While the trend from February to late September was generally higher for equities, this period was punctuated with a number of drawdowns. In particular, the trade issue that had lain dormant throughout 2017 came to the fore from late spring, as the US proposed and implemented a series of tariffs on trading partners. These resulted in retaliatory measures from these countries. The trade war had a negative impact on markets, especially as the scale and scope of proposed tariffs increased, particularly between the US and China. As a result, the pace of global growth began to slow, with regions more sensitive to trade being particularly badly affected, notably emerging markets and Europe.

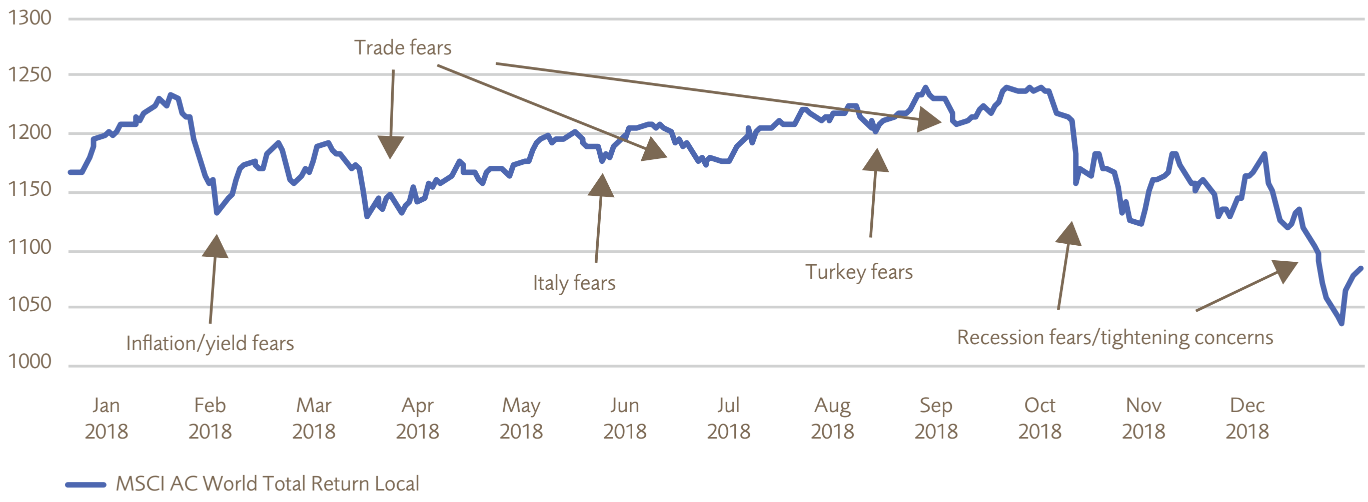
Moreover, political tensions also acted as headwinds to the global economy and markets throughout 2018. The ongoing Brexit saga, where there is still no clarity on the ultimate outcome, was a negative for UK and European economies and markets. The standoff between the populist Italian coalition government and the EU over Italy's expansionist fiscal plans, which contravened EU rules, also acted as a drag on Italian and other peripheral bonds, the euro and sentiment towards Europe in general. While a compromise was eventually reached in the dispute at year-end, with Italy lowering its fiscal targets, the episode was generally a negative for European assets. Additionally, US political concerns contributed to uncertainty, with mid-term elections resulting in a split Congress and a partial government shutdown at year-end adding to investor anxiety.

Despite these periodic setbacks, global equities managed to reach new all-time highs in late September on the back of still-solid global growth, even if it was increasingly dependent on the US economy, and strong global earnings growth, which again were very much US-driven.

Sentiment quickly changed early in the fourth quarter, however, as increasingly weak global economic data combined with tentative signs of softness in some US data led to growing concerns over a possible recession in 2019. Despite evidence of slower growth, the Fed appeared set to continue on a path of tightening policy though 2019 after rising rates by 0.25% in each quarter in 2018. This gave rise to fears that the Fed could possibly be making a policy mistake. Earnings revisions also turned negative for the first time in a couple of years, while political uncertainty rose towards year-end, both in the US and across Europe, which added to investor worries. As a result, global equities experienced one of the worst last quarters of the year in some time.

In addition to the global trade war, emerging markets in general were impacted by crises erupting in Turkey and Argentina, with the countries perceived to be more vulnerable in emerging markets experiencing pressure on asset flows.

GLOBAL EQUITY 2018



Source: Bloomberg

2019 OUTLOOK

So, following a traumatic 2018 what does 2019 hold in store for global equities?

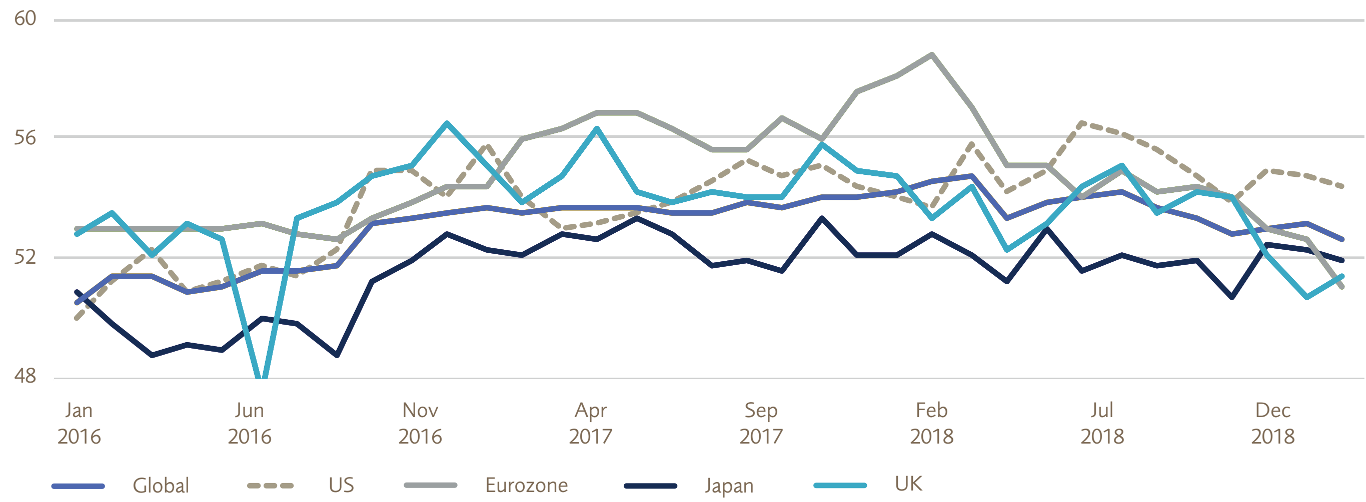
The main issue being faced by investors is whether or not the global economy will experience a recession in 2019. Risks to growth and the risk of a recession have clearly increased, and the direction of equities is still largely dependent on whether a recession can be avoided or not. Global growth has probably peaked, and equity markets have already discounted a slowdown, given the extent to which valuations have fallen throughout the fourth quarter. However, they probably have not fully discounted a recession, given the typical extent of the decline in earnings, valuation multiples and the equity markets when a recession occurs.

ECONOMIC BACKDROP

Global growth slowed in 2018 to an estimated 3.0% from 3.2% in 2017, and became increasingly reliant on the US economy; growth in the US improved to an estimated 3.1% in 2018 from 2.2% in the previous year. In contrast, growth in all other major economic regions slowed in 2018, with China growing by an annualised rate of around 6% in the third quarter, down from 6.9% in 2017 as a whole. Growth in the Eurozone also expanded by less than 1% year on year in the third quarter, with Italy and Germany contracting on a quarterly basis. Meanwhile, Japan also contracted in the same period, down -2.5% (annualised), due to distortions caused by severe weather events.

Global leading indicators, such as the regional composite purchasing managers' indices (PMIs) shown in the chart below, highlight how growth has slowed over the course of 2018. The PMIs are currently suggesting that growth will remain positive, with the current levels of global PMIs consistent with world growth of 2.9%. Various economic indicators across various regions are not suggesting economic activity or excesses have reached levels which typically would be associated with an imminent recession. In particular, bank lending surveys, consumer confidence levels, labour markets and housing markets are either not at levels, nor have rolled over to the extent, that would typically be associated with the onset of recession.

GLOBAL AND REGIONAL PMIs



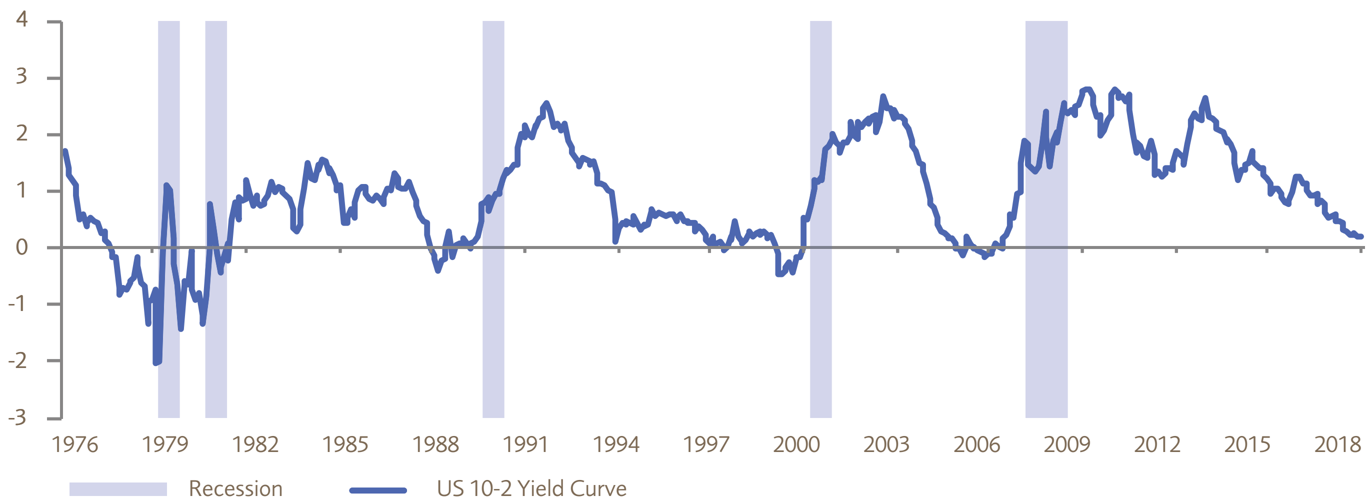
Source: Bloomberg

YIELD CURVE

There has been a particular focus on the shape of the US yield curve, specifically the difference between the yield on 2-year and 10-year US Treasuries. Flattening of the yield curve and, in particular, the inversion of the yield curve – when 2-year yields exceed the 10-year yield – is often seen as a leading indicator of recession. This occurs when the central bank is viewed as having raised short-term rates to the point where they begin to choke off growth and lead to a slowdown, which is reflected in lower yields in longer-dated maturities.

The chart below shows the US yields curve over time with US recessions represented by the shaded areas.

US YIELD CURVE AND RECESSIONS



Source: Bloomberg

While the 2-year/10-year curve has flattened in recent years, the curve is still positive, with 10-year yields currently exceeding 2-year yields by 16 basis points (bps). The flattening of the curve does suggest we are moving to the latter stages of the cycle, but is not indicating we are yet at the end of the cycle. With the US yield curve still currently having a positive slope, on the basis of history, the curve is suggesting that we will not have a recession in 2019 and is suggesting that equity markets have not yet peaked in this cycle.

GLOBAL TRADE

The risks to global growth around the trade issue eased through the summer as a new North American Free Trade Agreement was agreed, as was a truce in the trade dispute between the US and EU. Moreover, the US entered bilateral trade talks with Japan in an effort to reduce tariffs, while a new trade deal was signed with South Korea. These announcements significantly reduced the threat of a global trade war breaking out.

However, the most important dispute between the world's two largest economies, the US and China, remains unresolved and a continuation of the dispute could have negative repercussions for global growth. Recognising the growing risks of failing to resolve the dispute, both the US and China have begun to make efforts to find a solution and there have been expressions of a willingness to work together to implement a consensus on trade.

If growing hopes of a trade deal being agreed prove to be correct, then a significant factor behind the poorer sentiment and uncertainty around growth would be removed. However, as has happened previously, hopes have been raised only to be later dashed so investors will eagerly await the outcome of talks over the first two months of the year.

CENTRAL BANK POLICY

With regards to fears over the possibility of the Fed making a policy mistake on the rate tightening front, concerns have eased significantly compared with late last year. In a conference in the first week of January, US Fed Chairman Jerome Powell attempted to row back on earlier comments and soothe investors' concerns by stating that the Fed is prepared to be flexible and patient in relation to further rate rises, particularly given the modest level of inflation. This was a much more dovish approach than at the time of the Fed meeting in mid-December and suggests at least a temporary pause in rate hikes in the first half of the year. The market is currently discounting no further rate rises in 2019 compared to the official Fed guidance of two rate rises and Powell's recent comments suggest the final outcome is more likely to be closer to the markets view, particularly if inflation remains subdued. In this regard, the sharp fall in the oil price in the latter part of last year suggests inflation is more likely to surprise to the downside in 2019.

The European Central Bank (ECB) ended asset purchases under its quantitative easing (QE) programme in December. With QE having now ended, the ECB will be able to adopt a more dovish tone to policy guidance in 2019. The ECB most recently indicated that interest rates are unlikely to rise until at least through the summer of 2019 although the consensus in the market is that rates will not rise until June 2010. While recently saying risks to growth are balanced, the ECB did admit that these risks were increasingly moving to the downside.

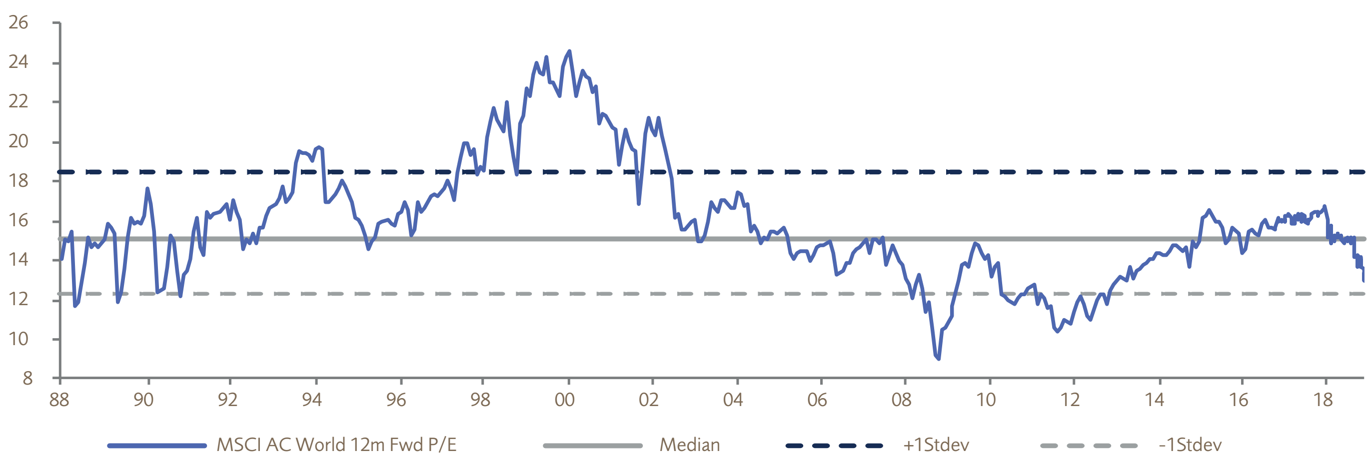
Overall, central banks are expected to be quite conscious of the potential impact of policy decisions on economies and markets in general and unlikely to blindly tighten policy to the extent that that growth will be choked off. As a result, we expect a significantly slower pace of policy tightening from central banks in 2019 with policy decisions being much more data dependent rather than being on auto pilot. Risks to growth from central banks' policy decisions should thus be considerably less than feared even just at the end of 2018.

EQUITY VALUATIONS

Following the rise of approximately 16% in global earnings last year, combined with the fall in equity markets, equity valuation multiples have experienced a significant derating.

On a 12-month forward P/E basis, global equities are currently trading at 13.1x, very much at the lower end of the range of the last 30 years, with the exception of the financial crisis. This is almost 1 standard deviation below the long-term average of 15.6x.

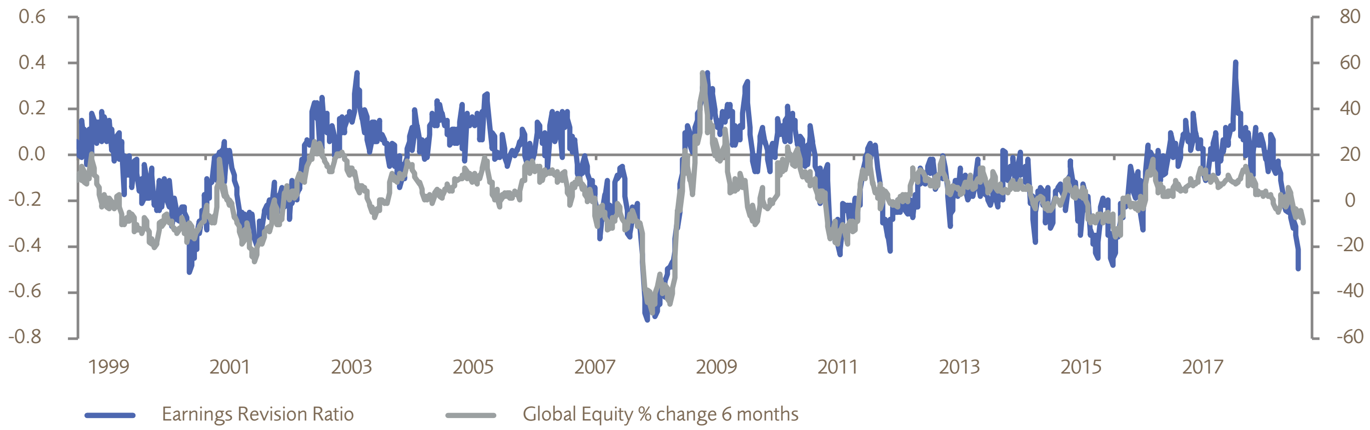
GLOBAL EQUITY 12 MONTH FWD P/E



Source: JP Morgan/Bloomberg

This multiple is obviously dependent on the level of earnings generated over the next 12 months. One of the reasons for the weakness in equity markets in the fourth quarter of 2018 was the negative trend in earnings revisions ratios. This measures the number of upgrades relative to downgrades when analysts change their earnings forecasts for companies. Earnings revision ratios are currently close to the lows of previous cycles, although it seems as if markets have not yet fully discounted the current level of downward earnings revisions. If fears around global economic growth subside, then earnings revisions ratios should begin to stabilise and recover, which would lend itself to a recovery in equity markets.

GLOBAL EARNINGS REVISIONS AND GLOBAL EQUITY MARKET CHANGE



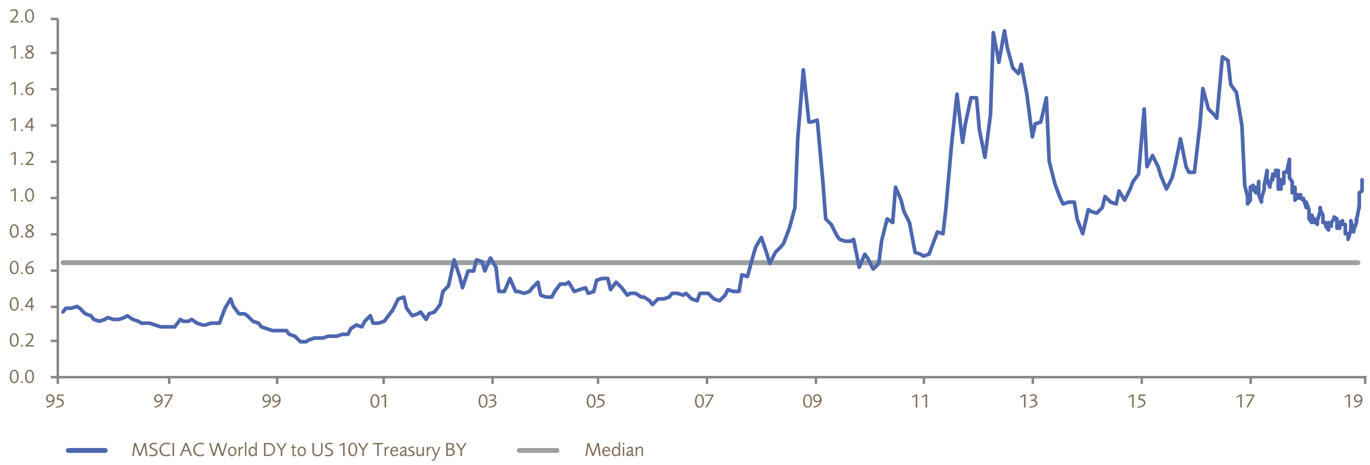
Source: Bloomberg

Consensus forecasts for global earnings growth in 2019 are still positive at 7.4%, albeit down from 9.7% at the end of September. Historically, even when earnings growth slows, so long as it remains positive, equity markets tend to perform well, with markets on average rising approximately 7.9% and being up over 70% of the time when earnings growth declines (but remains positive). As a result, equities should be supported if earnings are in line or even marginally below current consensus forecast for growth in 2019.

On other absolute valuation measures, such as dividend yield (currently 2.89%) and price-to-book (at 2.0x), global equities also appear attractive relative to their long-term averages of 2.6% and 2.17x, respectively.

Equites remain attractive on relative valuation measures, particularly against bonds. This is shown below in the dividend yield ratio chart, which compares dividend yields on equities against the yield on 10-year US Treasuries, used as a proxy for global bonds. With yields on equities exceeding those on bonds by more than the historic average, equities are still an attractive asset choice for investors.

GLOBAL EQUITY DIVIDEND YIELD RATIO



Source: JP Morgan/Bloomberg

US 10-year Treasury yields are currently around 2.62%. These would have to rise to approximately 4.0% before equities would be at fair value versus bonds, based on the average long-term dividend yield ratio. While some upward pressure on global sovereign bond yields is possible in 2019, we expect the US 10-year yield to remain below 4.0%, thus still providing a significant buffer in terms of how far yields can rise before they begin to pose a threat to equities, on a relative valuation basis.

POLITICAL RISKS

Political tensions have been a constant feature in recent years and are likely to remain a factor through 2019. Brexit, in particular, represents the greatest political risk and probably the issue with the greatest attached level of uncertainty. Confusion and uncertainty over the outcome of Brexit continued throughout 2018 and, if anything, increased towards year-end. A Withdrawal Treaty was agreed between the EU and UK, but the vote in the UK Parliament on whether to accept the deal was postponed until mid-January after wide cross-party opposition. Shortly after, Theresa May faced, and ultimately survived, a vote of no confidence in her leadership of the Conservative Party.

It is very difficult to predict with a high level of conviction what the ultimate outcome of Brexit will be, with a wide variety of outcomes possible. Overall, our sense is that we are less likely to end up with 'no deal hard Brexit', but the timing and path and the actual outcome itself remain very unclear. A more negative outcome in the form of a 'hard Brexit' would have particularly negative implications for the UK economy and equity markets. Moreover, European and global stocks would also be negatively impacted, although to a lesser degree.

Elsewhere, in the US, the November mid-term election resulted in a split Congress. This increases the risk of political and policy stalemate over the remainder of Trump's presidency and also increases risks around upcoming budget ceiling discussions. The increased risk of gridlock was evidenced by the partial government shutdown over year-end due to disagreements over funding for Trump's proposed border wall with Mexico, which added to the volatility and weakness in equity markets in late December. The dysfunctional and chaotic nature of the administration's policy agenda and makeup will probably continue to create uncertainty and remain a drag for markets.

Summary

The key determinant for the eventual outcome for global equities is likely to be the global growth environment. Despite some softening in economic momentum and recent evidence of growing concerns about a possible recession in 2019, our base case is that global growth will remain positive in 2019 (close to 3%) and a recession will be avoided. Recent indications that central banks will ease back, or possibly pause, recent tightening tendencies should remove some of the perceived risks to growth. Any resolution of the US-China trade dispute would also be supportive, as would the already planned increase in global fiscal stimulus in 2019.

Given current valuation levels in equity markets, a positive economic backdrop where a recession is avoided would be consistent with positive returns over the course of the year. Our base case is upside of 5–8% in equity markets for the year as a whole.

While equities are currently discounting an economic slowdown, they are not fully discounting a recession. If this outcome occurred, equity markets could fall over 10% from end-2018 levels.

Overall, given the ongoing uncertainty and number of risk factors overhanging markets, volatility is expected to remain a feature in equity markets through the year. Nevertheless, our base case is that equity markets will generate positive returns for investors once again in 2019 following the disappointment of 2018.

FIXED INCOME

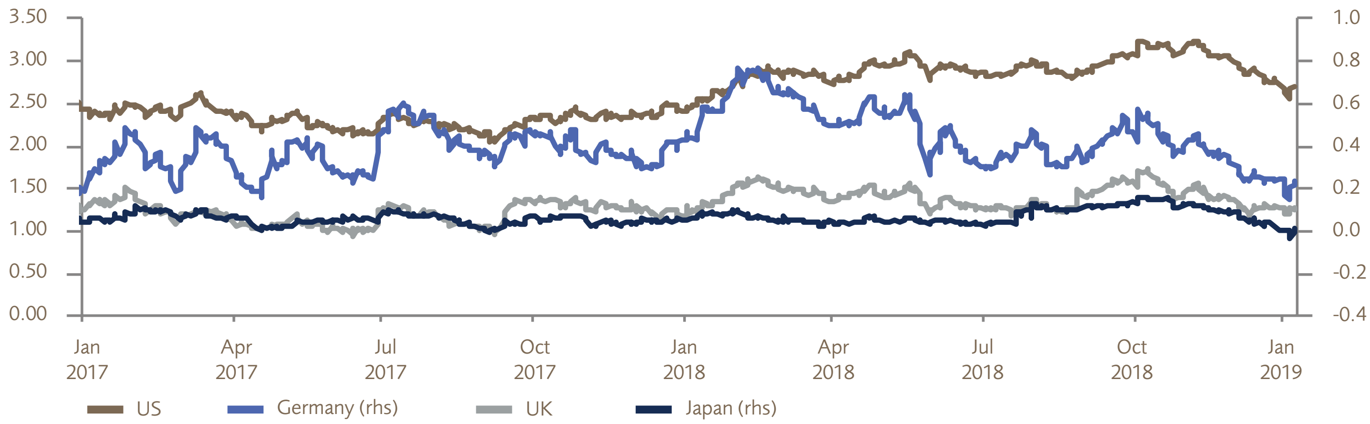
2018, THE YEAR OF US RATE RISES AND POLITICAL ANGST

SECTION 2

FIXED INCOME – 2018, THE YEAR OF US RATE RISES AND POLITICAL ANGST

- Review of 2018
- Outlook for 2019

10-YEAR BENCHMARK BOND YIELDS



Source: Bloomberg

REVIEW OF 2018

At the beginning of the year, 2018 global investment markets had made the following assumptions:

- The US fiscal stimulus would result in US GDP growth in excess of 3%
- The Fed would hike rates two to three times
- US-initiated trade wars would be amicably resolved
- Global growth would continue its synchronised upswing, with some moderation in China
- Inflation would pick up, with higher wage growth reflecting a tighter labour market
- Brexit would be resolved by September.

As the US growth assumption played out, the US labour market became tighter, with unemployment down to 3.7% and wage growth in excess of 3%. This allowed the Fed to steer a more hawkish course, with four rate hikes in 2018. Driven by strong third-quarter data and hawkish Fed comments, 10-year US Treasury yields peaked at 3.25% in September. However, a weaker fourth quarter saw the same yields back to 2.68% by year-end.

Meanwhile, 2018 did not work out as expected for the Eurozone. Ongoing trade war uncertainties, Italian politics, Brexit, the oil price at $80 per barrel and domestic issues (such as the drying up Rhine during the summer heatwave) led to a rapid slowdown in the Eurozone economy. At the end of 2018, leading indicators pointed towards a near standstill for economic growth in Europe. While bond yields rose in quarter one, with 10-year German bund yields as high as 0.8%, the remainder of the year was marked by a decline in core bond yields. At the same time, a blow-out in Italian bond yields, following the formation of a populist government with higher deficit spending plans, brought back memories of the peripheral bond crisis of 2012. While the Italian situation had been resolved to a certain degree by the end of quarter four, Brexit risks are likely to linger on for the foreseeable future. Low growth, low inflation and political uncertainty have again resulted in a flight to quality, with core government bonds the main beneficiaries. Ten-year German government bond yields are back at 0.25%, while Eurozone bonds (ICE BofAML Eurozone Government all maturity index) showed a return of 1% for 2018.

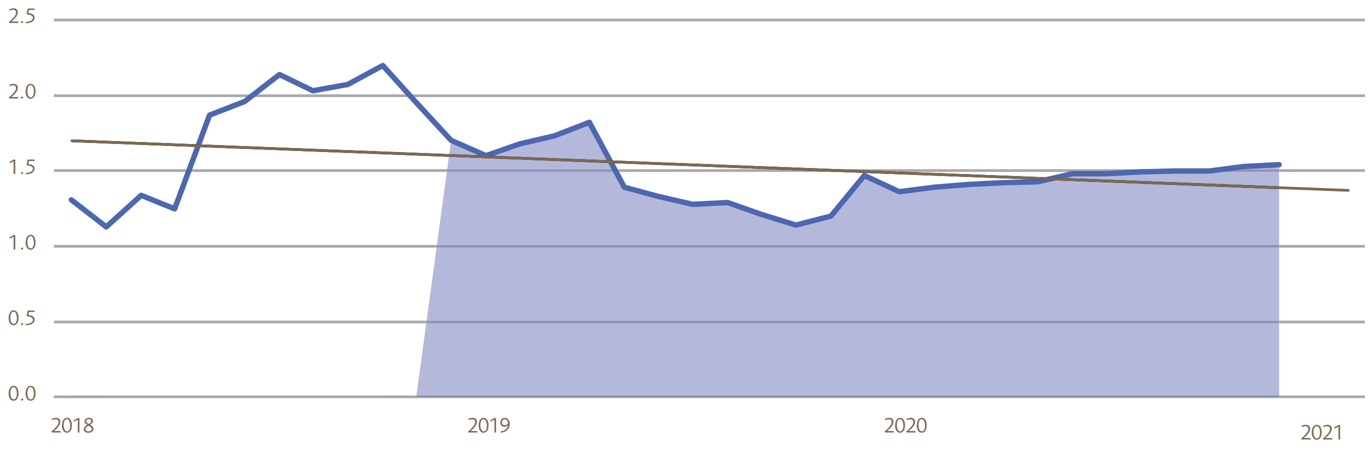
OUTLOOK FOR 2019

The year 2019 will start with much weaker growth assumptions than the year 2018:

- With the fiscal stimulus waning in 2019, US economic growth could drop below 2% in the second half of 2019
- Brexit will continue to be a drag on Europe, with the European elections in May another political milestone
- Base effects and lower commodity prices will see lower inflation, with the Eurozone Harmonised Index of Consumer Prices (HICP) expected to drop to below 1.5%
- The Fed and the ECB will find it difficult to justify hawkish rate hikes in 2019
- Without the ECB's quantitative easing, the net bond supply will increase in 2019.

In 2018, the ECB announced that it expected to hike rates for the first time after the summer of 2019. However, inflation will be a key issue required to justify any rate hike in 2019. The ECB's declared target is inflation at, or close to, 2%. Unfortunately, it looks as if inflation will be far off this target in 2019. Given that Brent crude oil prices reached $80 per barrel in 2018, commodity base effects will be a strong drag on inflation until the fourth quarter, as the end-year oil price dropped back to $54 per barrel. At the same time, lower economic growth and political uncertainties will not allow a repeat of the strong wage settlements seen in 2018. The graph below shows current inflation and the outlook (shaded in yellow) until late 2020.

EUROZONE HICP %Y/Y



Source: Barclays Capital

Another factor for the ECB will be the change in leadership – the term of the current President, Mario Draghi, will end in October. Given that the market is expecting the new leader to come from the dovish (pragmatic) camp, a wait-and-see approach might be adopted by the new ECB chair during the fourth quarter of 2019. Combined with the benign inflation outlook, the market is now pricing an initial rate hike in mid-2020. Our forecast is for 10-year German bond yields to remain in a range between 0.15% and 0.75%. Greater volatility can be expected for peripheral bond markets, with Italian debt to GDP rising again. European elections in May could be significant for peripheral bond markets, as populist parties have the potential to do well, and in return raise doubts about the stability of the Eurozone. With core bond yields close to the bottom end of our forecast, we expect Eurozone government bonds to have a zero to slightly negative return in 2019.

ALTERNATIVES

2018, A CHALLENGING YEAR FOR MANY HEDGE FUNDS

SECTION 3

ALTERNATIVES – 2018, A CHALLENGING YEAR FOR MANY HEDGE FUNDS

- 2018 in review
- Outlook for 2019

For many hedge fund strategies, 2018 was a year to forget. An increase in market volatility benefited some, but not all, and a sharp equity reversal caught out many managers early in the year. Strategies such as Macro and Commodity Trading Advisor (CTA), which engage in trend-following, were carrying elevated equity beta at the end of 2017 and into 2018. This generated losses during the reversal in February and again in October, as shown from the following Trend Index data.

TREND MANAGER FUND PERFORMANCE

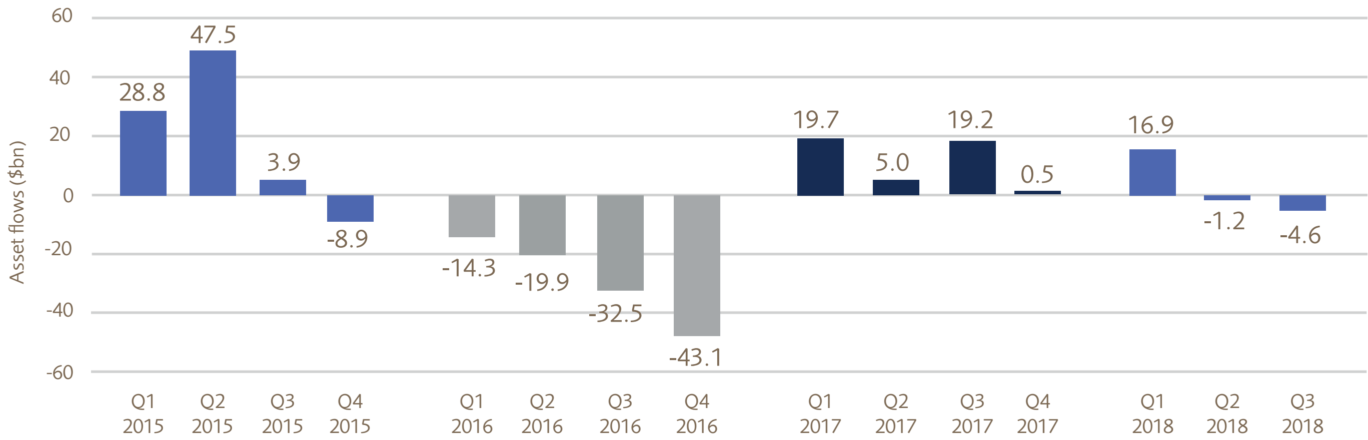
Source: Soc Gen CTA Trend Index

CTAs are known for their long-term return and diversification benefits, but they tend to detract in periods of short-term trend reversal. CTAs remain a valuable part of alternatives portfolios, with low correlation to risky assets over the long term.

Issues in Italy, Turkey and emerging markets generally had a negative bearing on a number of managers, especially Alternative Premia, or 'style factor' funds, in May and June. Fixed income carry trades would typically be long in peripheral bonds and short in core, a trend that unwound in this period. Equity and cross-asset value trades had underperformed until this point, in what was a challenging period for 'quant factor' investing. This was particularly the case in May and June.

As a result, Calastone reported that December was the worst month for hedge fund flows since October 2016. Meanwhile, eVestment reported hedge fund asset flows of -$14.77billion to the end of November.

HEDGE FUND ASSET FLOWS, Q1 2015 – Q3 2018



Source: Preqin

ALTERNATIVE BETA

Managers in the alternative beta/style factor space have been waiting for a reversal in the fortunes of value stocks for a considerable period, particularly after a difficult 2018. Last year continued the prior-year trend of a large number of new entrants to the market, offering style-factor strategies. It remains to be seen if this momentum persists in 2019, and if there will be suitable investor interest to meet supply.

Equity long/short continued to offer some compelling examples of managers' ability to generate returns in difficult conditions.

As large-cap tech giants experienced pricing wobbles in 2018, will there be more focus on fundamental value in the near future? Will the end of QE continue to put pressure on equity markets? There will always be a place for managers who are able to uncover good investment ideas in less-covered industries and geographical regions. Short ideas can also come from such a deep-dive approach, and we expect equity/long short to continue to be an important part of hedge fund portfolios in 2019, particularly if there is an increase in stock return dispersion.

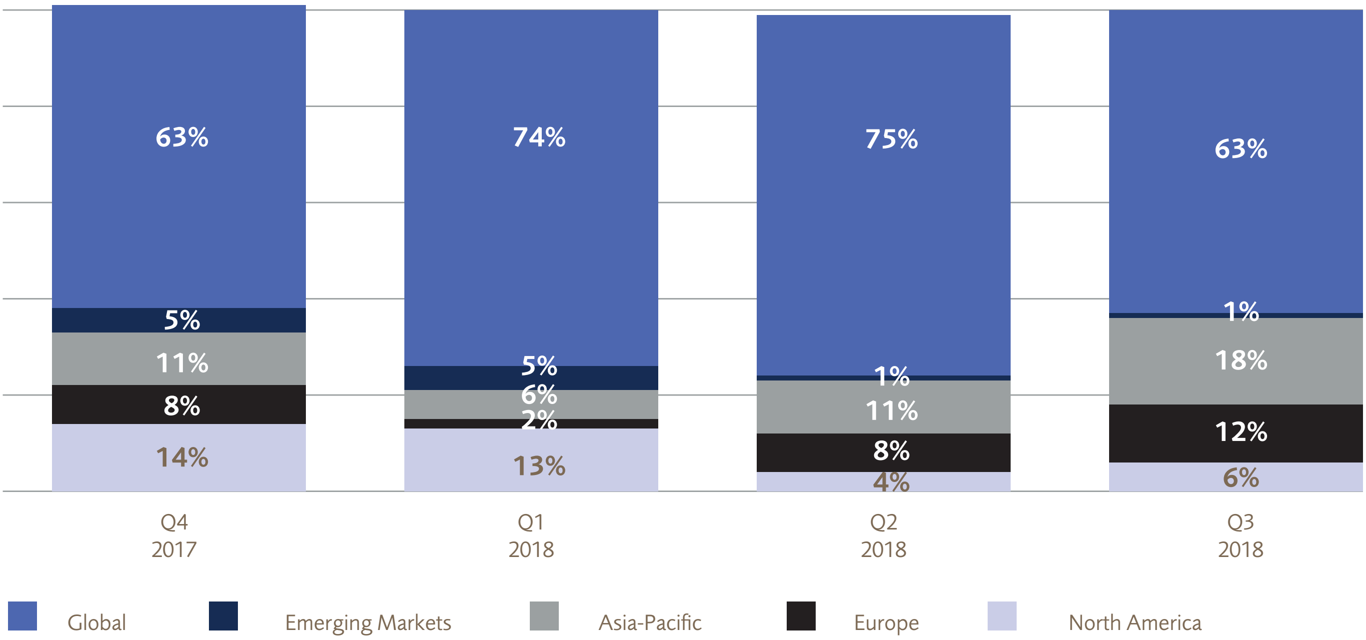
MERGER ARBITRAGE STRATEGIES

Merger arbitrage is among the strategies that held up well in 2018. We expect renewed focus on the general regulatory and economic environments, which may help or hinder such managers. As discussed in the 2018 outlook, merger arbitrage strategies often aim to make money by buying shares in a company that is the target of a takeover bid, in the hope that the shares will rise towards the offer price. Such strategies can also bet that the share price of the company making the bid will fall, aiming to make a return from the 'spread' between the two prices. Merger arbitrage strategies benefit from increased merger activity, but are particularly exposed to the probability of successful completion of mergers. The strategy type performed well in a rocky year for hedge funds, and all eyes will be on the deal-flow pipeline in 2019. Superior managers will select the most appropriate mergers in which to allocate. Which deals will break, and how will the unsuccessful mergers be avoided? The Trump administration in 2018 blocked what would have been the largest technology deal ever, Singapore-based Broadcom's attempted purchase of Qualcomm. Qualcomm, in turn, abandoned its bid to take over Dutch chipmaker NXP. These examples illustrate the political and regulatory risks mangers are consistently exposed to. US-China trade talks will also be watched closely for a thaw in relations that could provide a tailwind for mergers.

Quantitative hedge fund strategies continued to make news in 2018 following record inflows. They also made headlines during sharp market moves, and again took the blame for pricing shifts in December as the market traded thinly. Although factor-based quantitative strategies struggled through the year, some long-established quantitative macro and equity funds performed quite well. We could see consolidation in the sector, as some boutique-type quants who are under pressure following prolonged underperformance could be absorbed by larger firms. We think there is real potential for the stronger quantitative managers to perform well in 2019, making use of superior investment in technology, talent and infrastructure.

According to hedge fund research provider Preqin, the number of hedge funds coming to market remains high; the third quarter of 2018 saw new funds hit their highest level since early 2017. New equity strategies, in particular, have been coming on stream. We have also seen an increase in Asia-based managers, again illustrating the need to broaden geographic scope to obtain new sources of investment ideas.

HEDGE FUND LAUNCHES BY GEOGRAPHIC FOCUS, Q4 2017 – Q3 2018

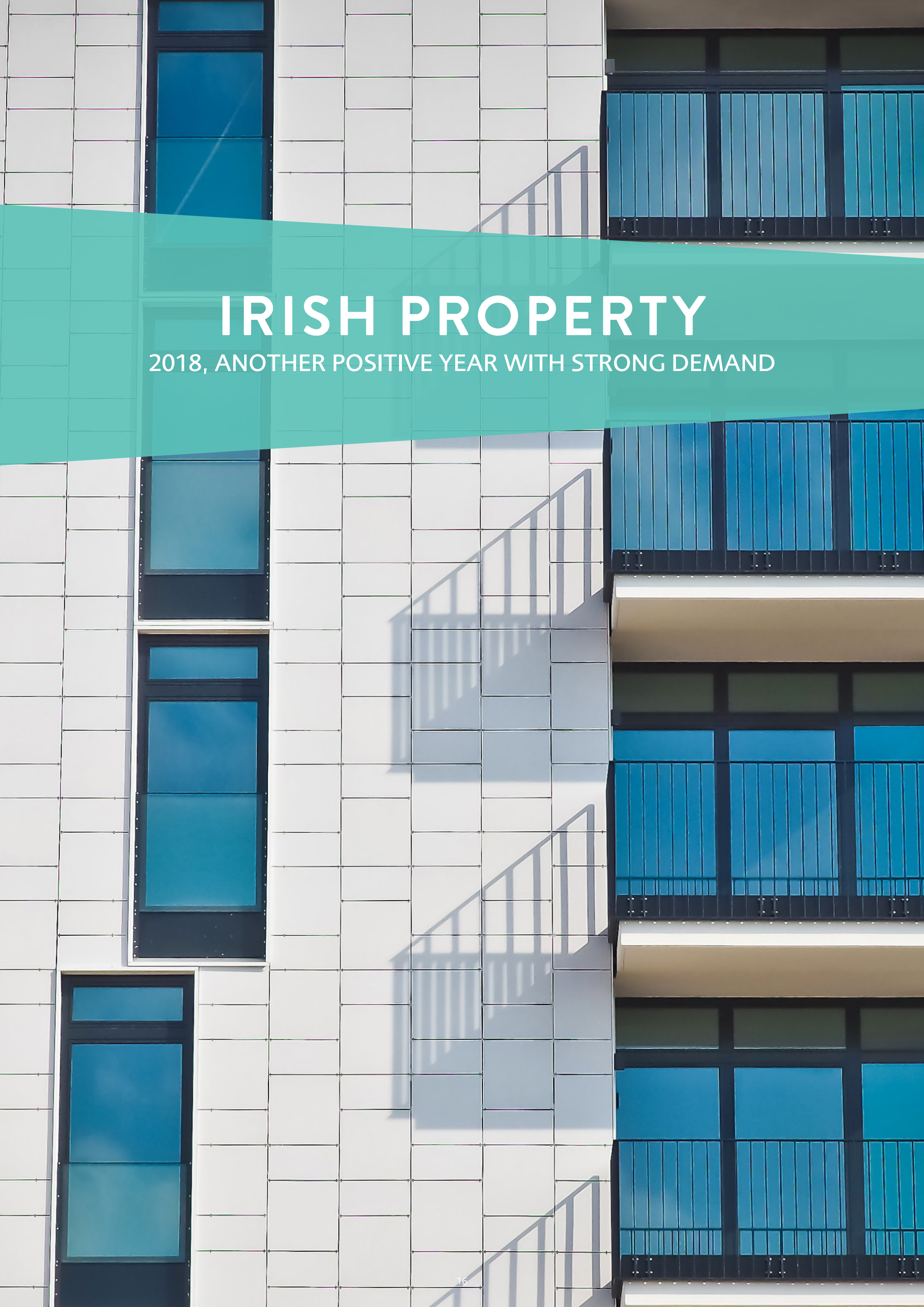


Source: Preqin

We have spoken before about the potential for CTA/Trend-Following strategies to generate positive returns in the event of sustained market downturns. We saw some short-term evidence of this in December, as CTAs that were positioned net short in equity futures benefited from a downward trend in equity futures. Should trends persist in either direction in the coming year, CTAs could be well placed to benefit.

IRISH PROPERTY

2018, ANOTHER POSITIVE YEAR WITH STRONG DEMAND



SECTION 4

IRISH PROPERTY – 2018, ANOTHER POSITIVE YEAR WITH STRONG DEMAND

- Key activities in 2018
- Outlook for property in 2019

The Irish property investment market delivered a solid, positive return for 2018, estimated to be 7–8%, made up of approximately 3% capital growth and around 4.5% income return. With prime market yields stable at relatively strong levels and rents similarly strong, particularly for prime office and industrial space, capital growth is predominantly being achieved through active asset management and development.

TRANSACTION ACTIVITY RISES

The investment market maintained its strong overall activity levels, despite coming off a number of years of record-breaking investment transactions. Turnover has remained in excess of €2 billion per year since 2014. Recorded turnover for the first three quarters of 2018 was €2.6 billion and estimations on fourth-quarter activity would put the annual amount close to €3.5 billion. For the first three quarters of the year, Dublin saw 81% of the investment turnover. While this figure highlights the capital's dominance as an investment location, the regional markets of Cork, Limerick and Galway accounted for a higher proportion and amount of investment than in previous years. The largest regional investment of 2018 was Kennedy Wilson's acquisition of The Elysian apartment complex for €87.5 million in the first quarter.

The consistency of high turnover levels up to, and including, 2018 is aided by contrasting underlying trends in each sector, which are evolving year on year. Over the past 12 months, the office sector has been the primary target for investment. Bolstered by strong occupational demand, and associated rental levels, high levels of capital continue to flow into development, refurbishment and standard investments. Some of the most significant office transactions included No. 4 and No. 5 Dublin Landings, North Docks for €210 million; New Century House, IFSC for €65 million; The Beckett Building, East Wall for €101 million; Eir Heuston South Quarter for €175 million; and No. 1 Dublin Landings, North Docks for €164 million. Investor demand for prime offices was led by core German funds, who are continuing to actively acquire, and Korean investors entering the market with a significant weight of capital available to deploy. Domestic institutional and REIT investors focused their office investment on development and refurbishment, following significant acquisition activity in the sector over prior years. Selective transactions have evidenced the prime office yield to be at 4%, but 4.25% is generally quoted as the established prime tone, representing a 0.25% reduction in yield over the year.

7–8 Henry Street

70 St Stephens Green

ILIM's office investment activity in 2018 was focused on refurbishment and development opportunities within the existing portfolio. A good example of our current office focus is 70 St Stephens Green. We secured planning permission and are under construction of a new 52,000 sq ft office building, which will deliver the highest environmental standards (LEED platinum and near zero) in an exceptional office location.

Investment in the retail sector in 2018 was polarised between prime assets, where strong pricing was achieved for the limited number of prime assets brought to the market, and non-prime retail assets, where negative sentiment is impacting investor interest. Key prime retail transactions were 7–8 Henry Street, a new MSU unit pre-let to Next, which sold during the third quarter for €44.25 million to Deutsche Bank, who also acquired West End Retail Park for €147.7 million in the second quarter. Also, IPUT has reportedly agreed to acquire Phase 1, The Park Retail Park for over €90 million from Warren Private Clients. ILIM's acquisitions in the retail sector in 2018 were focused on special interest opportunities, such as 4 Henry Street Dublin, where it holds the adjoining three properties.

Regional or secondary retail investments have been impacted by a swathe of negative news stories and performance results from mainly UK-based retailers. These resulted from behavioural shifts in consumer activity, where online retailing is benefiting, and Brexit, which appears to be influencing consumer sentiment. Despite a stable economic backdrop and retail performance in Ireland, attempted sales that failed to secure purchasers at acceptable levels for their vendors included Wilton Shopping Centre, Cork; City East Retail Park, Limerick; and Northside Shopping Centre, Coolock.

A shortage of stock has hampered high transaction volumes in the industrial sector; however, there were a number of sales during 2018 that underline the strong demand for this type of product among long-term investors. This demand is based on the yield margin above other sectors and the potential for further rental growth based on online-sales-driven occupier demand. Investor demand is focused on well-located modern buildings and competition for limited opportunities is resulting in some yield compression, with reported deals at levels in the region of 5%.

The emerging residential private rented sector (PRS) has increased its weighting as a constituent part of the investment market in 2018. Overall, 13% of turnover for the first three quarters of 2018 was in PRS, compared with 3% for the same period in 2017. The majority of the PRS investment opportunities coming to the market at present are for forward-funding projects, with delivery of actual buildings within two to three years. That said, the Elysian complex in Cork and The Grange, Stillorgan were among the largest standing investment sales of 2018, at €87.5 million and €161 million, respectively.

Fernbank, Dundrum

ILIM, on behalf of the Irish Residential Property Fund ICAV, completed its first residential investment, which was Fernbank, Dundrum – comprising 261 apartments and ancillary amenity space – for €138.5 million. The first phase of the complex has been completed and is currently being leased.

EXCEPTIONAL OFFICE OCCUPIER ACTIVITY BUT RETAIL SEEING SIGNIFICANT CHALLENGES

Office

A record take-up of office space was recorded in Dublin during 2017 and activity levels did not relent in 2018. While over 4.2 million sq ft was taken up in 2017, approximately 2.37 million sq ft had been taken up within the first nine months of the year and a further 2 million-plus sq ft reserved. Prime Dublin rents remained stable throughout 2018 at €55–€60 per square foot (psf), with a number of individual transactions achieving rates into the €60 psf for building or tenant-specific reasons.

This exceptional level of tenant demand is underpinned by large space takers, particularly the leading global technology companies, which accounted for approximately 41% of the take-up to the third quarter. The co-working sector, dominated in Dublin by WeWork and, to a lesser extent, Iconic, was responsible for 12% of take-up during the same period. The smaller size categories of up to 10,000 sq ft were also very active, with much of the new take-up coming from Brexit requirements, with UK-based businesses setting up new offices to provide a Eurozone presence. This resulted in good rental growth for well-located high-quality small buildings. However, occupier demand for mid-range requirements of 15,000–30,000 sq ft was lower during 2018, which has constrained rental growth in this segment.

While demand remains very strong in the traditional Central Business District, Docklands and Ballsbridge, activity is percolating to the best suburban locations and interest is growing for Dublin 8. Suburban rents remained stable during the year; however, there are pockets that have experienced higher proportionate increases in rental value, ostensibly a factor of affordability.

Retail

The retail sector is going through an adjustment period, as it adapts to rapidly changing consumer behaviour in terms of the what (greater leisure versus merchandise) and how (online versus bricks and mortar).

Brexit is also impacting the Irish retail market, due to the high proportion of British retailers located across the Irish retail landscape. Performance of these companies in their home market, as well as investor concerns over their share price for listed operators, are hampering their appetite for expansion. This is despite positive economic indicators and steady turnover performance in Ireland. However, continuing Brexit uncertainty, or a negative Brexit outcome, is expected to have a negative impact on domestic economic growth, consumer confidence and retail sales. While the scale of this impact is unclear at this point, this uncertainty does add risk, and property stock selection and asset management are key to a successful retail property outcome in the current environment.

Rents across most of Ireland's retail sub-markets have remained broadly static during 2018, albeit leasing evidence is mixed, with Grafton Street in the region of €550–€600 psf Zone A and Henry Street at €350–€400 psf Zone A. Likewise, the major Dublin shopping centres located along the M50 performed well during 2018. Pavilions Shopping Centre in Swords, in which ILIM holds 25% and is seeking to increase its ownership, experienced positive rental value growth during the year.

Industrial

Similar to the investment market for industrial space, the occupational market is being largely determined by the lack of sufficient supply of good quality space in prime locations. This has contributed to further rental value growth during 2018 in particular areas. In addition, some secondary locations are experiencing significant proportionate rental value growth as a factor of the low base rates they were at coming into the year.

Up to September, take-up for 2018 stood at approximately 2.3 million sq ft and is expected to end up close to 3 million sq ft for 2018 as a whole. This is ahead of activity in 2017, which was 2.5 million sq ft. Although prime rents have reached a point at which new development is now feasible, there is still limited speculative development taking place. A number of build-to-suit facilities have come on stream in 2018, at rents in excess of €9.00 psf.

OUTLOOK FOR PROPERTY IN 2019

The property market is positioned at a mature phase of the investment cycle; however, we expect that it will continue to attract good investor support this year, given the sector's defensive qualities and the challenging outlook for other investment classes.

We expect property returns for 2019 to be based on rental yield (currently at 4.5%), with further yield compression unlikely at this point in the cycle and prospects for rental growth varying by sector.

Active asset management of individual property assets will be key to delivering positive capital value growth at this point in the cycle. ILIM's portfolio is well positioned to deliver on value-enhancing projects.

Investment pricing for prime assets is expected to remain robust, based on continued investor support for the sector, a continuation of the low interest-rate environment and a good supply of high-quality investment products to attract potential buyers.

Core investor demand is expected to continue to come from overseas, as the market ownership continues to develop with existing overseas investors looking to add to their initial purchases and new participants seeking to gain exposure to the Irish market.

Investor demand and pricing for offices will be tested during the first half of 2019, as newly constructed and leased office investments, including The Reflector and 5 Hanover Quay in the South Docks, are brought to the market. Strong interest remains from core overseas investors and pricing is expected to remain solid, but this will be dependent on the investment markets view on the sustainability of office occupier demand and its impact on office rents.

While prime property investment demand remains good, weaker demand and pricing for non-prime may emerge in 2019. A significant number of other non-prime retail assets, held by private equity and opportunity funds, would be expected to trade over the short to medium term, given these investors are not long-term holders. However, with negative retail sentiment set to persist and limited investor interest, we would expect some of these assets to trade below current vendor pricing expectations.

The residential PRS market is at the early stages of its development and a good supply of development stock is in the pipeline. Very strong demographic trends and constricted supply are driving renter demand in the residential market, making it an attract investment option.

INDEX PERFORMANCES AND MARKET DATA

SECTION 5

INDEX PERFORMANCES AND MARKET DATA

Equity and Bond Markets % (in Local Currency)	2013	2014	2015	2016	2017	2018
MSCI AC World (Gross TR)	26.2	9.9	1.8	9.7	20.4	-7.2
ISEQ Overall Return	35.8	16.8	33.6	-2.7	9.7	-20.5
FTSE 100 TR	18.7	0.7	-1.3	19.1	11.8	-8.5
Euro Stoxx 50 TR	21.5	4.0	6.4	3.7	9.2	-12.0
S&P 500 TR	32.4	13.7	1.4	12	21.8	-4.4
Nasdaq Composite	38.3	13.4	5.7	7.5	28.2	-3.9
Nikkei 225	56.7	7.1	9.1	0.4	19.1	-10.2
MSCI Emerging Markets	0.9	2.6	-8.0	7.1	27.8	-12.2
Eurozone Government Bonds 1–5 yr	2.1	3.4	1.0	0.9	-0.2	0.0

Source: Moneymate

Sovereign 10yr Bond Yields (%)	2013	2014	2015	2016	2017	2018
US	3.0	2.2	2.2	2.4	2.4	2.7
German	1.9	0.5	0.6	0.2	0.4	0.2
UK	3.0	1.9	1.9	1.2	1.2	1.3
Japan	0.7	0.3	0.2	0.0	0.0	0.0
Ireland	3.4	1.3	1.1	0.7	0.7	0.9
Italy	4.1	2.1	1.6	1.8	2.0	2.8
Greece	8.2	9.6	7.9	7.1	4.1	4.4
Portugal	6.1	2.7	2.5	3.8	1.9	1.7
Spain	4.1	1.6	1.7	1.4	1.6	1.4

Source: Bloomberg

Central Bank Rates (%)	2013	2014	2015	2016	2017	2018
ECB	0.25	0.05	0.05	0.0	0.0	0.0
Bank of England	0.25	0.50	0.50	0.25	0.50	0.75
US Federal Reserve	0.25	0.25	0.50	0.75	1.50	2.50

Source: Bloomberg

Foreign Exchange Rates	2013	2014	2015	2016	2017	2018
Euro/Dollar (€/$)	1.37	1.21	1.09	1.04	1.20	1.15
Euro/Sterling (€/£)	0.83	0.78	0.75	0.84	0.89	0.90
Sterling/Dollar (£/$)	1.65	1.56	1.46	1.24	1.36	1.28

Source: Bloomberg

IPD All Property Return % (in Local Currency)	2013	2014	2015	2016	2017	2018
Ireland	12.3	36.1	25.1	12.6	8.1	5.5
UK	10.9	17.9	13.3	3.6	10.3	3.7
US	11.6	11.5	12.5	7.7	7.1	3.7

Source: IPD

Warning: Past performance is not a reliable guide to future performance

2018 figures shown are to 31 December 2018 except in the Property Returns which are to end of Quarter 3 2018.

DISCLOSURE STATEMENT

This document is intended as a general review of investment market conditions. It does not constitute an offer to buy or sell any investment or investment advice and has not been prepared based on the financial needs of objectives of any particular person, and does not take account of the specific needs of circumstances of any person.

Any comments on specific stocks are intended as an objective, independent view in relation to that stock generally, and not in relation to its suitability to any specific person.

Irish Life Investment Managers Limited is regulated by the Central Bank of Ireland.

Irish Life Investment Managers is an asset management company and is part of the Great West Lifeco Group of Companies.

Warning: Past performance, forecasts and simulated performance are not a reliable guide to future performance.

Warning: Investments may go down as well as up.

Warning: Changes in currency exchange rates may have an adverse effect on the value, price or income of the product.

The MSCI information may only be used for your internal use, may not be reproduced or redisseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages.

Bank of America Merrill Lynch - "Source BofAML, used with permission. BofAML is licensing the BofAML indices "as is," makes no warranties regarding same, does not guarantee the suitability, quality, accuracy, timeliness, and/or completeness of the BofAML indices or any data included in, related to, or derived therefrom, assumes no liability in connection with their use, and does not sponsor, endorse, or recommend Irish Life, or any of its products or services."

NOTES

Irish Life

CONTACT

RETAIL INVESTMENT DEVELOPMENT

PHONE: 01 704 1200

EMAIL: RetailInvestmentTeam@ilim.ie

WEBSITE: ww.ilim.ie - www.irishlife.ie

BLOG: http://blog.irishlife.ie

YOUTUBE: www.youtube.com/ilimweb